

Feb. 12, 1997

LETTER 1219

DEMAND: Every market in its essence boils down to supply and demand. The demand equation in this bull market is unlike any ever seen before. The **automatic** transfer from pension plans and salaries to mutual funds, and from the funds to the stock market is unprecedented. And the question on every thinking investor's mind is, "How will it all end?" It will end the way every bull market in history has ended -- in exhaustion. Ah, you ask, but where's the exhaustion point? The great irony of the market is that no one on the face of the planet knows.

PRIMARY TREND: With all the hoop-la that we are subject to each day via newspapers, TV, radio, and brokerage handouts, we tend to forget the **KEY**, the single most important consideration in investing. That consideration is the direction of the great primary trend of the market.

I have always likened the primary trend to the irrepressible tide of the ocean. When the tide is coming in, nothing can stop it. The tide will continue to rise until its momentum has weakened and finally ended. The same phenomenon holds true when the tide runs out.

So what do we look for in the stock market now? First, we can look for new highs in my "Big Four," the Dow, the S&P 500, the advance-decline ratio and the Primary Trend Index. The high for the Dow was **6883.90**. The high for the S&P was **789.26**. The high for the A-D ratio was **+3.78**. The PTI high was **4808**.

On February 4, the S&P 500 hit a record high of 789.26. The Dow, the A-D ratio and the PTI failed to confirm, although the PTI recorded a double top (see page 2 chart).

A "**key**" reversal (often termed a "one-day reversal") occurs when the market opens higher on big volume, then later reverses and ends the day lower. We have seen three "key" reversals recently, the first on January 23, the second on January 31, and the third on February 5. All three key reversals started from the Dow 6860 to 6880 area. It appears that there is major resistance and a willingness by traders to sell whenever the Dow enters the area above 6880.

For those looking for **real weakness**, a technical "breakdown" will occur if the Dow closes below its January 28 closing low of 6656.07, confirmed with a Transport closing below 2318.86. Note that neither the Dow nor the Transports have been able, so far, to confirm the February 4 record high in the S&P 500.

Well Known Measurements: The cyclical negatives of the stock market are very well known. (1) There's the negative of a poor third year after back-to-back huge years in which the market has advanced by 20% or more in each year. (2) There's the usually poor fifth year of a presidential term. (3)

Jan. 31 DJIA 6813.09; PTI 4805; A-D Ratio +3.87
Feb. 7 DJIA 6855.80; PTI 4814; A-D Ratio +3.94
Dow Yield: 1.95%; Dow Price/Earnings: 19.3
Dow 144-day MA: 6239; Dow 34-day MA: 6688
Dow Times Book Value: 5.12; PTI 89-day MA: 4730
Percentage of Undervalued Blue-chips: 4%
Gold 144-day MA: 375; Gold-PTI: 126

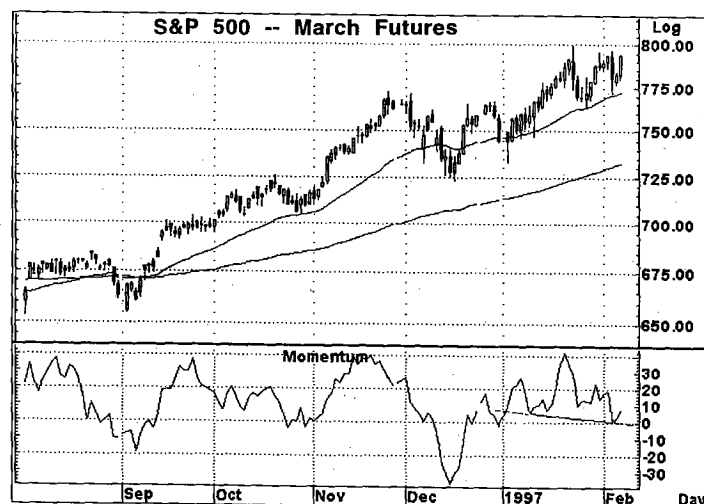
There's the negative of the 7th year of the decennial pattern. (4) And there's the fact that this is the most uncorrected stock market in history.

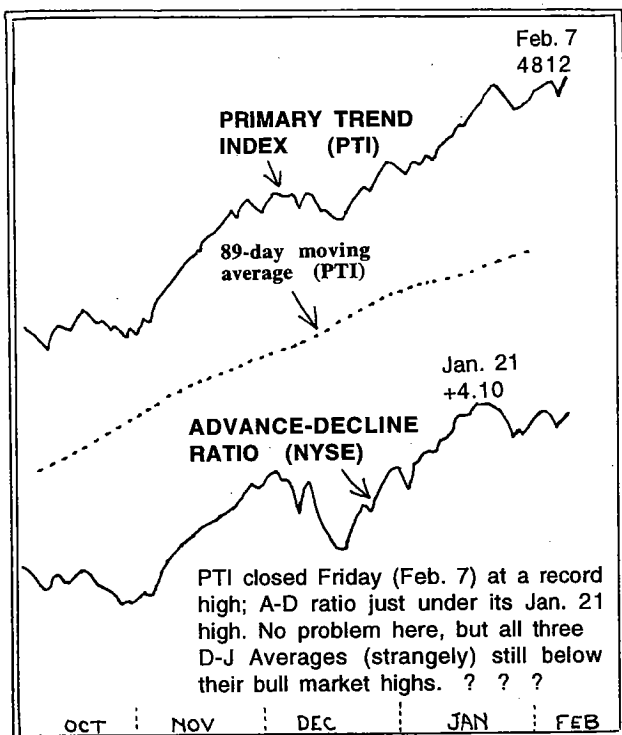
Then there are the negatives having to do with stock market overvaluation. (1) The Dow is selling at over 50 times its dividends. (2) The Dow is selling at five times its book value. (3) The S&P is selling at 21.40 times *record* earnings. (4) Both averages are selling at dividend yields below 2%. (5) The earnings yield on both the Dow and the S&P are well below the current long-term bond yield. (6) *IQ Trends* of La Jolla shows that a record low 3% of the 350 Blue-Chip stocks that they monitor are now "Undervalued."

Joe Granville (who is now very bullish) argues that all the above items are **too well known**, therefore they have pretty much lost their significance. Joe has a good point. But just how good a point Joe has I'm not sure. For instance, just because people are aware that the stock market is overvalued doesn't mean that overvaluation is meaningless.

I happen to think that the valuation comparisons are important. Overvaluation isn't an opinion or a sentiment, it's an historical **FACT**. Then again, you have to remember that expensive markets can get **MORE** expensive -- which is what this market has been doing for years.

Here's my conclusion: all the above "negatives" are interesting and many are important. There's enough there to make me cautious. But I've learned over the years to place my greatest trust in **market action**. What the market is "supposed to do" is always worth knowing and paying attention to -- but what the market is **actually doing** is where I center my attention.





Now let's talk a little market philosophy. We're in a bull market. And the operative Dow Theory thesis is, "*The trend is taken to remain in force until proved otherwise.*" So far, we've had no "otherwise" to worry or upset us, so why put any energy into wondering "if the stock market is topping out?" or "when will the stock market top out?"

The answer is that it's the nature of this business to generate worry and wonder. When the market is declining we wonder, "How or when the decline will end?" When the market is rising we wonder, "How long can it continue to rise and when the rise will end?" That's the investment business -- questions, wondering, worries, trying to figure out what's going on and how long will it go on? It's both the curse and the fascination of the stock market.

For the page 1 chart, this time I'm showing a daily chart of the **S&P 500 March Futures**. In Letter #1211 I explained why the S&P Futures now "run" the stock market. Thus, it's more important than ever to watch the futures. The S&P futures hit new highs last week. If weakness is to appear, here's what I'm watching. The first level of importance is 787. If that's violated the next level is at the 34-week moving average which now stands at 770. This is very close to the critical January 29 closing low of 771.50.

Of particular interest is Momentum (a 13-week rate-of-change) shown at the bottom of the chart. Here we see an unusual "head-and-shoulder" top type pattern. This pattern suggests that the massive upside momentum of this market could be slowing down.

CREATE, THEN DISTRIBUTE: The business of Wall Street is distributing securities to the public. The Morgan Stanley/Dean Witter Discover merger fits perfectly into Wall Street's objective. Morgan Stanley will dream up "deals," and Dean Witter will move 'em out. Stately Morgan Stanley wants the ability to distribute more "product," and Dean Witter has 9,300 salesmen who can sell the product. The merger has been likened to Saks Fifth Avenue merging with Sears. It's class merging with mass.

What's really behind the merger? Read the following (from the Feb. 6 *NY Times*): "The middle class has fallen in love with the stock market. Last year, Americans poured \$235 billion into mutual funds, by far the most popular household investing vehicle. Nearly all that was placed in funds that invest in the booming stock market rather than in bonds or money market instruments. By comparison, the public invested just \$22 billion in mutual funds in 1990." **Russell comment:** The October low for the Dow in 1990 was 2365.

The merger will make Morgan Stanley/Dean Witter #1 in global merger and acquisition advisory, #1 in initial public offerings, #1 in credit card customers, #1 in common stock issuance overall, #2 in stock market research, #5 in mutual fund assets, and #8 in muni bond offerings. There will be 399 offices worldwide, 3.2 million in retail customers, and 7 million mutual fund owners.

VOLATILITY: "Implied volatility" reflects the confidence or nervousness (fear) that option-sellers feel about the market. When option-sellers are nervous and want protection, they price options high and implied volatility is correspondingly high. Conversely, when option-sellers are confident and unworried, they price options low and volatility is correspondingly low.

The following is from the current issue of *Futures* magazine: "Undoubtedly the most misunderstood and overlooked factor affecting option pricing is volatility -- which refers to the *level of uncertainty* a market exhibits. When a market starts to 'heat up,' its volatility is increasing. Conversely, when a market is 'dead,' its volatility is low." **Russell comment:** Volatility in the current stock market has been holding near **record highs**, and it's no wonder -- in all the 45 years I've been watching the stock market, this one has to go down as the wildest. **The current record high volatility reflects option-sellers' nervousness and uncertainty regarding both sides of the market -- the market has "upside momentum and could spurt higher," but at the same time the market is "expensive, overbought and uncorrected and could collapse."**

INVESTMENT POSITION: The bull remains in the box. It's no small thing to take the bull out and replace him with a bear. It takes a lot more than a simple reversal of a one-week decline.



So far, the market acts more like a "tired bull" than anything else, but a tired bull is still a bull. As explained earlier, we've recently experienced three key reversals in the market, but as usual (at least so far), there's been no downside follow-through after the initial weakness. One thing is clear however, and it's that the urge to sell on rallies is increasing.

Investor's Business Daily's Mutual Fund Index (an average of 20 leading equity mutual funds) keeps registering new lows in relative strength. The high for the Index was registered last May. My own feeling (guess) is that it's going to be increasingly difficult to make money in the market as 1997 moves along. Act accordingly.

"EXTREME BUYING" -- James Alphier was a brilliant market student, and I corresponded with him frequently during the '80s (sadly, Jim died at a young age some years ago).

Jim did extensive and original work in detecting great buying areas in the stock market. The March 19, 1984 *Barron's* published an article by Jim entitled, "**Prolonged Liquidation.**" In this article

Alphier presented his unique formula for identifying great buy spots as follows: in any 14-week period if there are at least 17 more down days than up days, the market is extremely oversold -- and it's a "buy."

Alphier's article listed the great buy spots of the past under his system. Alphier pointed to July 30, 1982 as his latest great buy area (remember, the article was written in March of '82). The Dow was just under 800 at that time. A few weeks later, on August 23 the Dow sank to an extreme low of 776.92. By the end of that year the Dow had surged to 1070. From there it was onward and upward. Jim Alphier had indeed identified a great buy area.

From experience I know that "oversold" areas are more reliable for buying purposes than "overbought" areas are for selling purposes. Nevertheless, I've always been fascinated with any technique which can identify what I consider "highly dangerous" overbought areas in the market.

I might add that just as Alphier's "prolonged liquidation" studies are based on market ACTION, I would favor an extreme or "prolonged buying" method based on market action (as opposed to say sentiment studies).

I don't know if this is THE answer, but in Peter Eliades' latest "Stockmarket Cycles" report [(707)579-8444] Peter presents a thesis that I find fascinating. It is based on a kind of reverse version of Jim Alphier's studies:

The following is what Eliades has found. In monitoring all the monthly Dow closes of this century: there have never been more than 30 up-months within any 40-month period. Actually, prior to 1996 there have only been two periods in which there were 30 Dow "up months" out of a 40-month period. The first of these occurred in **February 1937**. The bull market topped out a month later in March of '37. The Dow then declined to a June low, rallied to a peak below the March high, and then collapsed (the Dow lost 50% of its value).

The second period of 30-out-of-40 up-months occurred during **April through August of 1961**. That was the warning signal. In April the Dow was in the 680 area, and by the end of August the Dow had climbed to 719. By December the Dow was at 734. However, the 1961 warnings gave way to a crushing 1962 decline, a decline which took the Dow from a January 1962 high of 726 to a June low of 535, a drop of 26% in a period of six months.

Now here's what's so interesting -- in **October and November of 1996** and again in **January of '97** the Dow was up **30 out of 40 months**.

What does this mean? It suggests to me that the market is again in the grip of what I term "extreme buying."

Wait, there's more -- Peter Eliades subjects this same study to **periods of 100 months**. He notes that the greatest number of up-months for the Dow **within a 100-month span was 69**. That series occurred in December of 1961, just prior to the 1962 smash. Other than that instance, there were only two periods in this century in which the Dow was up **68 out of 100 months**. These two periods were 1966 and now. The 1966 period of "extreme buying" occurred in January, February and April of '66. The Dow hit a high of 995.15 in February of '66, then headed south. By October the Dow had fallen to 744.42 (my veteran subscribers remember this collapse only too well).

The other period of 68 up-months out of a 100 is now -- **November and December of 1996 and January of '97**.

Conclusion: I'm fully aware that records are made to be broken. Nevertheless, I think the implications of the above study should be taken seriously. The fact that the Dow has been up 30 out of the last 40 months and 68 out of the last 100 months indicates extreme and prolonged buying.

Remember, the function of the market is to look ahead, to **discount the future**. At some point the market always discounts the very best that can be seen ahead. Once that happens, a bear trend takes over. The significance of the "extreme buying" study is that it tells us that the market is now at a rare juncture. It's a juncture which, in the past, has suggested that the **BEST HAS BEEN DISCOUNTED**. It will be fascinating to see whether history repeats.

Note: Remember "the market can do anything." And this market has certainly lived up to that aphorism. At this point, my Primary Trend Index becomes particularly important, mainly because it pays no attention to overbought or oversold areas or sentiment or whether the market is up 30 out of 40 months or 39 out of 40 months. The PTI basically "grades" each day's action, thereby telling us what the market is actually doing minus all technical studies, minus all historical studies, minus all hopes and wishes, minus everything but the supply and demand for stocks.

NOTES & QUOTES: Remember back a few years when all eyes were on each week's money supply statistics? Few people pay attention to the money supply figures anymore, but according to the tables in *Grant's Interest Rate Observer* the three-month (annualized rate) of growth in the M2 money supply is 7.9% and for the broader M3 it's 8.5%. This kind of activity in the money supply suggests that both the economy and inflation could be heating up.

Boeing has announced that it has decided to drop plans for its long-talked about "Super-Jumbo" commercial airliner. But Airbus, the four-nation European consortium, is going ahead with their Jumbo, a plane which will carry up to and maybe more than 500 passengers. "We are going to stick to our schedule, no matter what Boeing does," said an Airbus spokesman. "That means the consortium is to begin construction next year, conduct test flights in 2001 and deliver the first aircraft by 2003." **Russell comment:** Thus, Airbus is betting probably its whole future on one project that Boeing has deemed non-commercial.

The dollar has been super-strong. From its April 1995 low, the dollar has risen 52% against the yen and 20% against the German mark. This chart tells the story. What this means is tougher times for US exporters and easier times for nations selling to the US (US auto manufacturers are screaming already). Treasury Secretary Rubin keeps telling the nation that a strong dollar is desirable and that it reflects the power of America. The question, of course, is **HOW STRONG** a dollar US exporters can live with.

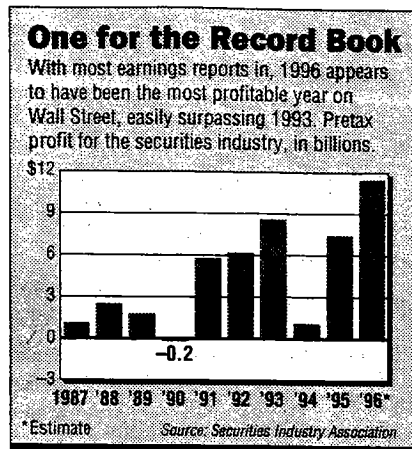
The strength or weakness of a nation's currency reflects the strength or weakness of a nation's economy. Two weeks ago Japanese Finance Minister Hiroshi Mitsuzuka warned that the weakening of the yen "has gone too far." Ironically, the structure of the Japanese economy has changed. A good deal of Japanese manufacturing is now done outside of Japan, and this means (ironically) that Japanese manufacturers benefit less from a cheap yen. In the past a falling yen has been a plus for the Japanese stock market, but this time it's different. The declining yen has simply generated increased pessimism regarding the Japanese economy, and it has cooled any bullishness towards Japanese stocks.



What's the world's largest company? It's GE, which has now replaced Nippon Telegraph and Telephone in the latest FT Global

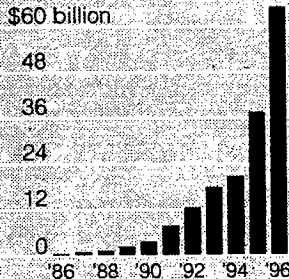
500, which ranks companies by capitalization. Next comes Royal Dutch/Shell, while Coca Cola is third.

WALL STREET: The Street is having FUN. The year 1996 was the most profitable year in its long history. As this chart shows, Wall Street's pre-tax profits last year was just short of a whopping



A Market Darling

Index mutual fund assets.



\$12 billion. The second chart shows the growing trend towards index mutual funds. The fact is that most mutual funds have not been able to keep up with the S&P. So people are asking themselves, "Why be a stock-picker, why mess with mutual funds that don't keep up with the ever-rising market? I'll just move into index funds and ride the rainbow." There are over 150 index funds out there with new ones being formed weekly.

Wall Street has its fad indicators. Remember the Confidence Index, Will-Go, the money supply, and on and on? The current fad comprises the wages, employment and unemployment figures. Analysts wait breathlessly for each new installment of these statistics. Why? Well, if employment is booming, the Fed might raise rates, while if employment levels off, the Fed will probably leave rates alone.

Maureen Dowd of the *NY Times* calls him "President Smarmy." I guess I'm tired of writing about our president and all his "indiscretions" and slipshod activities. Last week the *LA Times* (strongly Democrat) couldn't take it any more and headlined it, "Fund-Raisers' Use of White House Database Reported. Law prohibits providing information from computer system, established at Clinton's behest, for non-government use. Spokesman denies illegality." And so it goes.

The Super Bowl is over, and Green Bay has the crown, at least this year (they're already talking about a "dynasty"). What I love about sports is that you can spend hours pouring over the possibilities of your team winning, you can spend a full day at the stadium watching your team play, you can get as emotional as you want -- and the nice part of it is that *it really doesn't matter at all*.

Speaking of football, many wonder whether free agency hasn't ruined the game. With players and teams hopping from job to job and city to city, you don't know what your team will look like next year or even if it will be in your city. The fact is that the ratings for regular season games were down on all five networks that carried NFL games, and this was the second successive year of across-the-board declines. ABC's "Monday Night Football" recorded its lowest ratings ever. I know I feel a lot less interested in football than I did a few years ago.

Columnist Richard Cohen in the *International Herald Tribune* states, "With all due respect, Clinton is not a great man -- in fact, he could not be. Among other things, he is the victim of poor timing. The country is both peaceful and prosperous, and Bill Clinton, as he must surely know, has made only a marginal contribution to any of this. On account of that rotten luck, history will merely note him, and then move on to something more

interesting." **Russell comment:** All very true -- up to now Clinton has done nothing of importance. In his inaugural speech, Clinton said, "We have resolved for our time a great debate over the role of government." **Russell comment:** So if Clinton stands for anything, it's that big government is important and it can solve problems. Of course, if Clinton has to deal with a bear market and a severe recession during his second term, his work (which up to now has been basically campaigning and endless talking) will be cut out for him.

Where your money goes: The IRS reports that it spent \$4 billion on a modern computer system that never worked. Now the IRS proposes contracting out their tax processing to private companies. The problem, however, is that confidential tax returns would be available to non-government workers.

Economist **Lester Thurow** writes that "the traditional family has disappeared almost everywhere . . . In America 32% of all men 25 to 34 years of age earn less than the amount necessary to keep a family of four above the poverty line. While male wages are falling at the bottom, the costs of supporting a family are rising . . . Economically many men, perhaps a majority, are being told that they should not plan to have a family since there is no probability that they will be able to support a family. Women are under enormous pressure because the economy gives them one message (go to work and make the money the family needs to survive), and old cultural mores give them another message (stay home and take care of the children). They feel stressed because they are stressed . . . Men end up having strong economic incentives to bail out of family relations and responsibilities because they raise their own living standards when they do so . . . Among families with dependent children, 25% don't have a male present . . . Values follow economic realities. Individual fulfillment now ranks higher than family in public opinion polls . . . When children do exist, parents spend less time with them -- 40% less than they did 30 years ago. Female-headed households where females provide 50% or more of total income are becoming the norm. With mothers at work, more than 2 million children are left completely without adult supervision, both before and after school . . . Family values are under attack, not by government programs that discourage family formation (although there are some) but by the economic system itself. It simply won't allow families to exist in the old-fashioned way, with a father who generates most of the earnings and a mother who does most of the nurturing. The one-earner middle-class family is extinct." **Russell comment:** Do you wonder why the US prison population has doubled in the last decade? To my mind the culprits are (1) decades of inflation, (2) big government, and its "solutions" to social problems, and (3) liberalism and the philosophy that "rights" are everything and "responsibilities" are unimportant.

California has its Silicon Valley. New York, unknown to most, has its Silicon Alley. The latter is the name given to the confluence of hundreds of small companies staffed by creative people who are drawn to NY. Where once lofts were filled with neophyte rock and roll bands, these same lofts have been replaced by people producing sites for the World Wide Web. With an eye to the huge potential of the Internet, Microsoft has come to Gotham searching for and looking to buy promising original programming from NY's downtown digital entrepreneurs, who create everything from interactive soap operas to on-line magazines. In fact, Microsoft's Laura Stein is in NY on a mission for MSFT's Multimedia Productions. So New Yorkers, if you've got anything of Internet importance to sell, give Ms. Laura a call -- she's waiting. And MSFT's got the cash to buy you out -- \$9 billion of it.

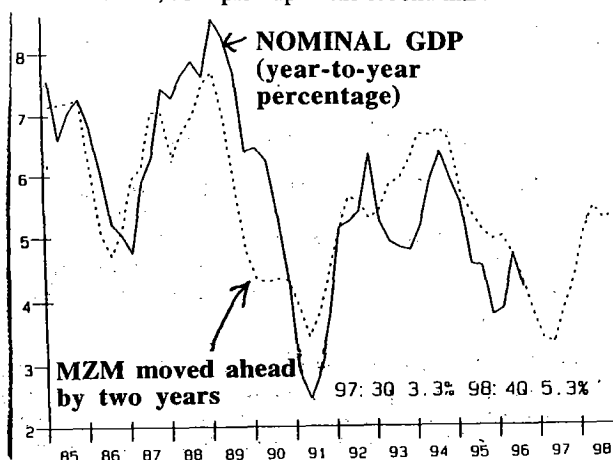
Land: Who's the biggest land owner in the US? No, it's not Donald Trump, it's none other than Jane Fonda's husband, Ted Turner. Turner (they no longer call him "the Mouth of the South") owns land in Montana, Nebraska, Florida, Georgia and South Carolina -- more than 1.3 million acres. Turner also owns more Buffalo (American Bison) than anyone else. Bison meat, like Ostrich meat, is low in cholesterol. I've eaten buff-burgers and they're OK.

Hong Kong's stock market is at record highs, but there could be trouble. Within six months China will be taking over Hong Kong and a panel of Chinese advisors meeting in Beijing has proposed drastically curtailing Hong Kong's newfound civil liberties. This has set off cries of outrage from local politicians -- it's the first real test for China's hand-picked chief executive, Tung Chee-Hwa. The panel has proposed scrapping or amending 25 local ordinances; worse, the panel wants to gut the colonies 1991 bill of rights. The panel also proposed restoring power to the police to ban peaceful demonstrations, restoring control on groups having links with overseas organizations and rolling back privacy laws that protect personal files and data of local citizens. All this would take place after China takes control of Hong Kong on July 1. **Russell comment:** The talk up to now has been that China will leave Hong Kong pretty much alone, fearing to mess up the "Golden Goose." But it doesn't look as though it's going to work out that way. China's leaders continue to want dictatorship with a limited brand of free enterprise.

This from the *International Herald Tribune*: "From the vast scale of Chinese investment, it appears that virtually every entity in China -- from the smallest southern fishing village to the most powerful ministry -- wants a piece of Hong Kong's economic boom. Almost every Chinese provincial government has a company here. The army is thought to be the largest investor in Hong Kong, a large number of the estimated 20,000 companies under its control worldwide are believed to be in Hong Kong."

Speaking of China, the Chinese have passed Japan in buying US Treasury securities. In the year ending in September, the Chinese bought \$12.1 billion in Treasuries vs. Japanese's \$11.6 billion. Foreign ownership of Treasuries is now 30% of the total outstanding. Which means, of course, that 30% of Treasury interest goes out of the country.

Ed Hyman of the *ISI Group* shows this chart of MZM (money of zero maturity) and nominal Gross Domestic Product. The GDP is shown as a year-to-year percentage change. When MZM is charted two years out, it shows a remarkable ability to lead the trend of the economy. According to this chart, GDP should slow down during the first half of '97, then pick up in the second half.



I don't know how many of my subscribers are serious traders, but for those who are I can recommend a FAX service written by an old friend of mine, Chick Goslin. Chick has been trading commodities as long as I can remember, and he writes with clarity and modesty. He uses a momentum method of trading, which makes a lot of sense to me. Chick includes much wisdom and trading techniques in each daily report. If interested call Chick at (619)456-7820.

Russell Opinions: I used to listen to Larry King on radio when he was just a regular guy. Now he's turned into a pompous, name-dropping sycophant (he has a *USA Today* column). How did it happen? I guess any power corrupts some people, sad . . .

Maureen Dowd's columns in the *NY Times* are terrific; she's a breath of fresh, honest air compared with King's pompous fluff . . . *Los Angeles* magazine (February) contains a scathing article on Barry Sears and the Zone. The article calls Sears the "weird Zone czar," . . . "scientist, visionary and entrepreneurial opportunist" . . . San Diego is in the midst of a huge and costly fight regarding the expansion and financing of its stadium. The City is in danger of losing Super Bowl XXXII which is scheduled to be played here in '98. San Diegans are a strange breed -- there are so many outdoor activities and things to do here, that the good citizens care little about movies, big time sports or anything except sand, ocean, skiing and surfing. And oh yes, SD is a Republican stronghold and very conservative regarding finances. As for dress, SD is also the home of the T-shirt and jeans.

America's big investment banks are moving into Europe. According to the *Financial Times*, "Goldman Sachs and Morgan Stanley have widened their lead over the big European banks." Says Britain's *Acquisition Monthly* magazine, "Europe is like the wild, wild West right now. If someone is selling a company in Europe, they ask who has got the international expertise, and more and more it's the American banks."

The Russian Accounting Chamber has called for an immediate halt in the sale of Russian diamonds. The reason: Russian diamond stockpiles will run out by the middle of next year. The move will add to a growing impression among western diamond traders that there might be a shortage of diamonds by the year 2000, and that the price of gem quality diamonds is due to rise.

Peter Drucker is a top-name economist, and people pay a lot of money to listen to him. The following bits were taken from a recent interview: "There is only one big city in the world where public transportation still works, and that's Chicago. Los Angeles is hopeless, New York is demeaning, and London is not much better . . . I think you could probably merge the US Agriculture and Commerce Departments and have a Department of the Economy. Instead of which my prediction is coming true, predicted in 1960, that by the year 2000 there would be more employees in the Department of Agriculture than American farmers . . . Newt Gingrich is probably the first political entrepreneur in America since the New Deal. The casualty rate of entrepreneurs is very high. I think he's finished. In part because, and this is typical of entrepreneurs, they're egomaniacs. If they're not, they don't succeed. And, in part because he tried to do too many things. This is also a typical mistake of entrepreneurs. If he'd concentrated on one or two things, he might have succeeded."

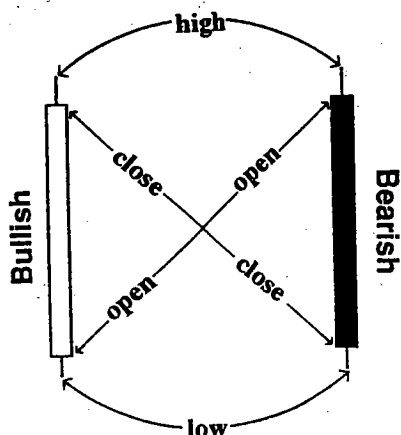
Uh oh, it's finally happening. The Harley mystique is fading, and "everybody" now rides Harleys. Suddenly, unsold bikes are sitting in dealers' showrooms. In the meantime, Harley Davidson has pushed bike production up to 200,000 a year. *American Iron* magazine in its editorial notes that salesmen, "due to past frenzied production, haven't had to sell a Harley at list price for years. The era of order-takers masquerading as salesmen and outrageous mark-ups is fast coming to an end and the decision makers at Harley better plan accordingly."

According to a Reuters poll, more than half of US voters have money in the stock market, and more than half say they would not sell if stock prices dropped dramatically. The poll results showed that 61% are in for the long haul and that 24% stated they are "very much" in the stock market for retirement purposes.

CANDLESTICKS, KEY REVERSALS: Subscribers have probably noticed that I have, in many cases, been using Japanese candlestick charts in these Letters. The reason is simple -- candlestick charts provide additional information -- and they are simple and logical. Up-days are white, down days are black.

This little diagram may clarify how you interpret candlesticks. The white rectangles signify up-days; the bottom of the white rectangle denotes the opening for the day and the top of the white rectangle denotes the close for the day. The thin vertical lines or tails show

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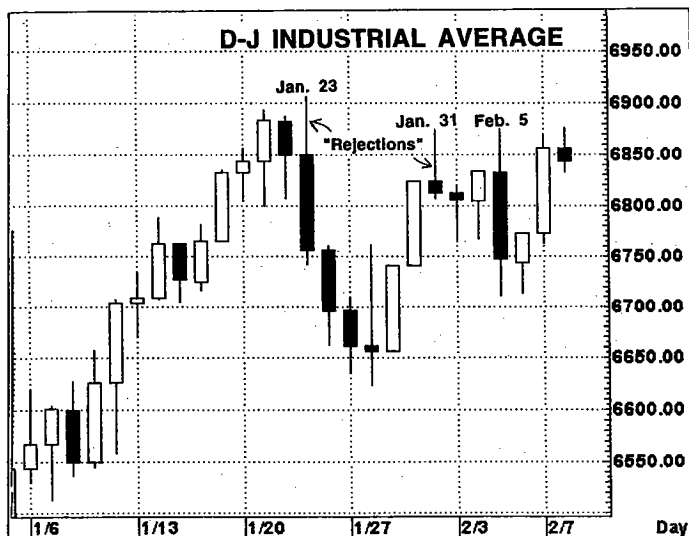
the day's high and the day's low. The exact reverse applies to the black rectangle, which signifies a down-day.

Occasionally, we see a long vertical tail and this can be significant. I call these long tails "rejections." A long tail on the upside means that the market has rejected the advance; a long tail on the downside means that the market has rejected the decline.

I include this study now because it may tell us something about the current market (at least for the short term). Please study the accompanying daily chart of the Dow.

Note that we have three tails or rejections on the upside, the first occurred on January 23, the second on January 31 and the third on February 5. Each of these tails were formed by violent one-day reversals from higher markets during most of the day to violent sell-offs near the close. These sell-offs or rejections are what produced the long tails.

By Friday's close (Jan. 7), the Dow had again plowed into the same area which had produced three previous reversals. By the time you receive this Letter you'll know whether the Dow has advanced to a new high or whether a fourth rejection has occurred.



GOLD, DOLLARS: Gold is the only real money, but right now gold is being treated by investors strictly as "emergency money." In other words, the only reason to hold gold is that if "everything goes," if, say, a bear market hits and there are questions about EVERYTHING, that's when gold comes into its own. Gold comes into its own because gold is the ONLY money that possesses intrinsic value. Dollars can go literally bankrupt via inflation, lesser

currencies can go bankrupt as a government collapses, but gold remains gold through wars, revolution, inflation, and bankruptcies.

But wait -- dollars are now on the global throne. Europe has its problems of high unemployment and semi-recession, plus the specter of a single currency that not everybody trusts. Japan's yen is collapsing and its economy is in question.

On the other hand, the US economy is strong (if not booming), US interest rates are the highest of any major nation, US technology lead the world, and the US is the only remaining super-power. As a result, the dollar is the king-pin, better than any other major currency. Furthermore, why hold gold which pays no dividends when you can buy inflation-adjusted bonds from the US government?

All the above has hurt gold. Furthermore, for insurance or emergency purposes, it currently makes more sense to hold the actual metal than it does to hold the gold stocks. Why? Because for insurance purposes, nothing can happen to the metal from an intrinsic standpoint (i.e., it will always be money) but a lot can happen to any gold stock or gold stocks in general.

What can we say of the gold action? Let's take the most hopeful aspect of the picture. This daily chart of XAU, the Phila. Gold/Silver Average, recorded an extreme low of 106.94 on January 8. It hasn't been below that since. The most hopeful aspect of this chart is that momentum is rising as XAU falls. Could this be calling for a bottom? We'll see.



LATE NOTES: This is written Monday morning, many hours before the close. Referring to the Dow chart (opposite), the last little black bar refers to today, Monday, well before the close. Obviously, I don't know whether the Dow is going to surge to a new record high, or whether those previous "rejections" mean that sellers will prevail.

With the S&P and the PTI at new highs, the odds would seem to favor a confirming new high by the Dow. But odds are one thing, and what the market actually does is another, so we'll have to await the verdict of the marketplace. One thing is clear -- *selling pressure is increasing as the market works higher*. At some point (today, next month or a year from now) sellers will prevail, and the market will top out.

I don't think I've ever experienced a period when the sentiment, the "inner gut feeling" was literally screaming that "the market MUST AND WILL GO HIGHER." I've been watching markets since the mid-40s, and I admit that I feel it myself. Ah, that's emotion.

As this is written, the D-J Industrials, Transports and Utilities have failed to confirm new highs in the S&P 500. That's very unusual. We should shortly know whether it's meaningless -- or whether it's that subtle but critical warning that almost nobody seems to have recognized.